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**THE PICTURE:** Remember back about six or eight months ago when many of the pessimists were claiming that "this is just a rally in a major bear market." It's really hard to take that position now. Why? Because the advance in the market has been too extended, too strong and it has taken almost all the major indices from the Dow to the S&P 500 to the Wilshire 5000 to new record highs. Here are the statistics for the year 1985 so far: Dow up 24.7%, D-J Transports up 23%, D-J Utilities up 12%, S&P 500 up 23%, Amex up 18%, Value Line Composite up 18%, NASDQ up 29%. C'mon, this is no bear market rally!

How about upside confirmations? How about this: on the closing December 11, all four NYSE indices hit record highs as did all six S&P indices. On the same day, all the Dow Jones averages hit record highs except Utilities which were off by less than a point. Again on the same day, the A-D ratio and my PTI hit new highs. Talk about upside confirmations, you don't see that kind of bull market action once in five years.

One of the concepts I've been voicing all year is that as long as it's a bull market all reactions, dips, consolidations and confusing movements will be resolved (in due time) to the UPSIDE. By definition that's what a primary bull market does -- it ultimately takes the average and the majority of stocks to new highs. Once a bear market takes over the opposite is true. But as I've repeated ad nauseam, we have had no Dow Theory bear signals and no bearish PTI signals. Thus, in the absence of bear signals, we must conclude that the bull reigns.

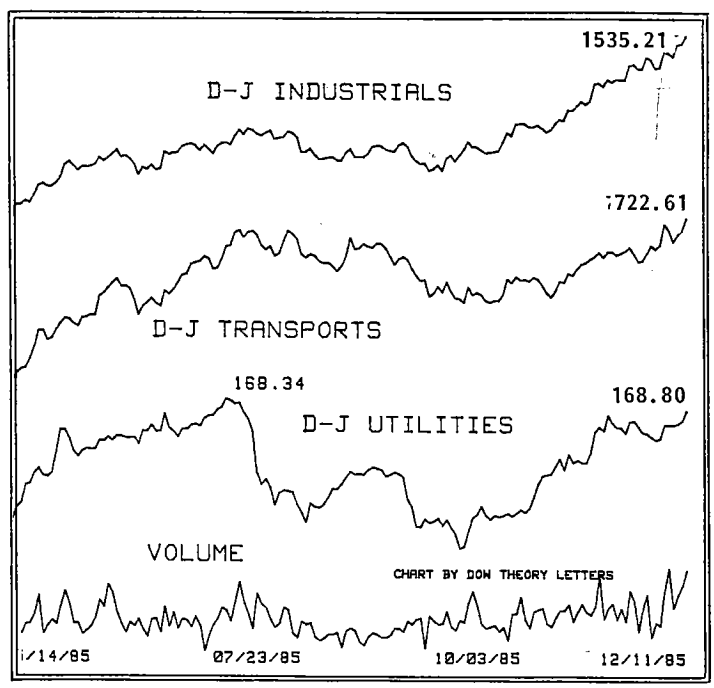
A bull market's (diabolical) objective is to advance itself as far as possible without the public being aboard. A bear market's (nasty) objective is to go down as far as possible while keeping the public firmly aboard. Yeah, it's not nice, but nobody ever claimed that markets are nice. Markets are created by man, but it's been said that nothing invented by the mind of man has frustrated him as much as the stock market.

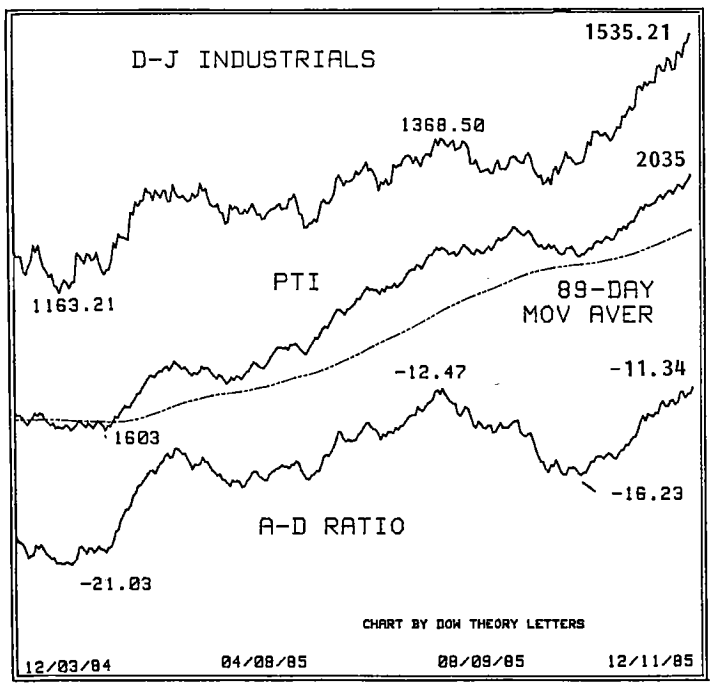
For instance, during the 1950s and '60s when everyone was tuned in to the economy and the fundamentals, the bull market would use bearish business statistics and scary news to keep the public out of the great bull market (i.e., recessions, Sputnik, Eisenhower heart attack, Korean war, etc.). But today the public is much more sophisticated, and the technical approach to the market is not only accepted, it is embraced. So what does the ornery bull market do? It offers a collection of technical worries such as non-confirmations, divergences, lagging averages, all calculated to keeping people from participating in the bull market.

This will be the last Letter before Christmas. I have subscribers from all over the globe and of every religion. Unfortunately, I only know Merry Christmas and Happy Chanukah, but that should cover most of you. The year 1985 was a very good one for us, and happily we were with it on both stocks and bonds. Gold and silver bugs didn't make any money, but I've been saying all year that that wasn't where the action was. How about 1986? I'll tell you all about it in the next Letter. Let's take it one year at a time.

I was one of the writers who popularized the technical approach back in the late '50s and early '60s. I popularized it via my Letters and a series of 17 Dow Theory articles in Barron's. By the mid-1960s every other bank and brokerage house in the country was reading my reports. It was about that time that I felt that too many "technicians" were following the same indices and indicators. I felt further that I had better develop some device for monitoring the technical strength (or weakness) of the market that could NOT BE FOLLOWED by other advisors and investors. After three years of experimenting I came up with the Primary Trend Index (PTI). I have been following this index on a daily basis ever since.

The PTI is an amalgam of eight critical indices and averages, and it is so constructed that it reflects the primary trend of the market. The PTI often leads the averages, sometimes runs coincident to the averages, and occasionally, it even lags the averages and the rest of the market. But when the PTI is in a






well-defined rising trend (such as now) the market will consolidate at worst, and continue to rise at best. So I developed the slogan, "Ignore the PTI if you wish, but don't ever go against the PTI." In all my advice in these reports, you will notice that I always stay on the right side of the PTI. And that procedure has saved me from a lot of embarrassing or even disastrous decisions.

Because there still seems to be confusion at this time about what the market is saying, I want to go over one concept that is familiar to almost every veteran investor. And that is the old adage, "News follows the trend." Anyone who has watched the market and the economy over a few bull and bear cycles (and this usually takes 10 to 20 years) has noticed that during a bull market almost all problems tend to be resolved bullishly. If they can't be solved (such as the foreign debts to US banks) then they just seem to disappear, to slowly fade away (or at worst, they are held over until the next bear market).

So my opinion is as follows: (1) there are a great many problems and unknowns which will materialize in the period ahead, problems from the tax bill to the deficit mess to the foreign loans. But the market obviously likes what it sees, and it thinks that most of these problems will be "handled" or bullishly resolved, and (2) before this bull market is over we are going to see a period of euphoria comparable to any of the previous euphoric periods such as 1928-29 or 1964-65. Why? Because that's the way bull markets end -- with a wildly enthusiastic public, a new era psychology and nary a cloud in the sky.

In the meantime, the following thoughts are offered at this time: The first is a very simple one. This is a bull market, and if you still haven't got your thinking oriented to the bull side, it is time to do so. Second thought: a tremendous amount of time is being spent by the newspapers and various advisories regarding the "next reaction" or the "coming bear market". This is basically a healthy pastime, but a more profitable pastime here would be to keep your investments aligned with the primary bull market.

Next thought: primary bull markets as massive and extended as this one don't end with a whimper -- they end with an explosion of rampant enthusiasm. Personally, I don't think we have seen that kind of enthusiasm yet. For instance, on December 5 the NYSE produced 181 million shares of volume, fourth largest volume day in history. But the market was down across the board on December 5. The huge volume wasn't an indication of market euphoria, it was basically a period of profit-taking for traders and speculators. My bet is that before this bull breathes its last we are going to see record volume day after day on the upside. That period still lies ahead.

**INVESTMENT POSITION:** The PTI has been higher nine weeks in a row, and that's upside action you don't see very often. Nevertheless, even the Chicago Bears had to lose one after 12 straight wins. Therefore, we should not be shocked to see a reactive week. In fact, a down week or two would be entirely healthy for both the stock and bond markets. The bull is in the box, and it looks as though he is there to stay for quite a while longer. The reason I say that is that the public (which usually winds up a bull move) continues to be strangely wary of this giant bull advance.

Good yields are still offered by some of the closed-end bond funds on the NYSE; funds such as Amer. Capital Bond, Excelsior, Current Income, plus Lincoln Private Placement, a favorite of mine. J.P. Morgan, recommended here repeatedly, has been a star over the last month and has just raised its dividend for the umpteenth time in the past 10 years. I continue to believe that Morgan is the class of the big city bank stocks.

**MEGA-BREAKOUT:** I am indebted to "The Primary Trend", 1st Savings Bldg., 700 N. Water St., Milwaukee, WI 53202, for this extraordinary chart (page 3). I published this same chart in Letter 861 (May 18, 1983), but I wanted to update the graph in view of what has occurred since then.

In the long history of the Averages, there have only been three very extended consolidations, consolidations of 13 years or more. All three are shown on this chart. The first one started in 1906 (it included the Panic of 1907) and lasted until 1924. Following the 1924 breakout, the Dow climbed roughly 280% to the 1929 high of 381.

Following the 1929-32 crash, the Dow advanced to the 1937 high of 194. From there the next long-term trading range began (this range included the bear market crash of 1937). The subsequent long-term consolidation lasted from 1937 to 1950, a period of 13 years.

In 1950, the Dow broke out above the 212 ceiling. What followed from this historic breakout was an incredible 16 year climb (up 370%) to the 1966 Dow high of 995. Many of my current subscribers were reading these reports at that time, and it was in early 1966 that I stated that the great bull market of the 1950s and '60s had ended.

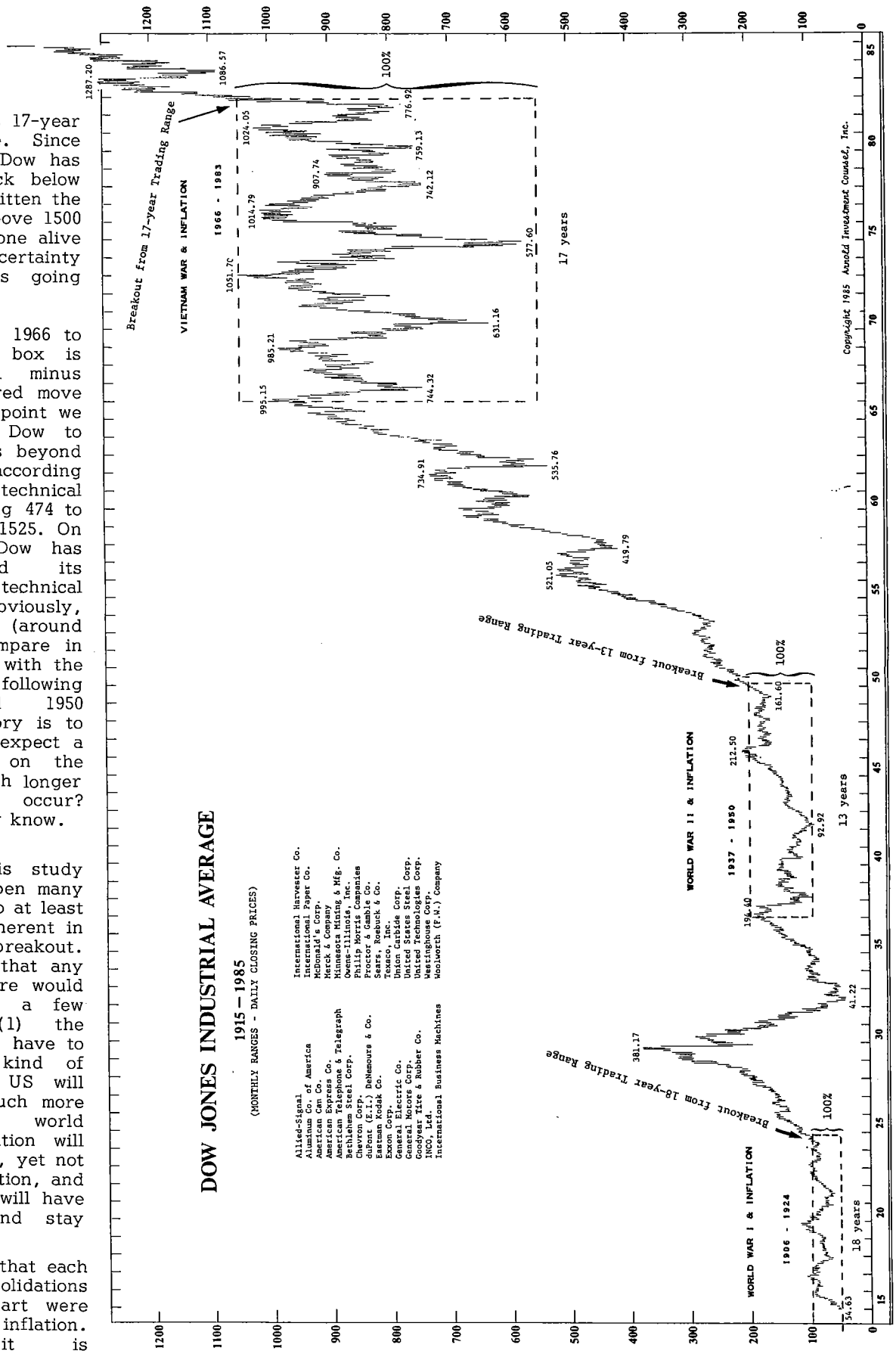
Again market students witnessed an extended (seemingly endless) consolidation (a consolidation which included the disastrous bear market of 1973-74). But all's well that ends well. In early 1983 the Dow finally

broke out above its 17-year consolidation range. Since the breakout, the Dow has never dropped back below 1000. As this is written the Dow has climbed above 1500 and of course no one alive can say with certainty where the Dow is going from here.

The height of the 1966 to 1983 consolidation box is 474 points (1051 minus 577). On a measured move from the breakout point we could expect the Dow to tack on 474 points beyond 1051 peak (this is according to classical technical analysis). So adding 474 to 1051 we arrive at 1525. On that basis, the Dow has already achieved its minimum upside technical objective. But obviously, the current high (around 1500) does not compare in duration or extent with the tremendous rises following the 1924 and 1950 breakouts. If history is to repeat, we might expect a good deal more on the upside over a much longer time. Will that occur? Nobody can possibly know.

But I include this study because it might open many subscribers' eyes to at least the possibilities inherent in the 1983 breakout. Personally, I feel that any major rise from here would be predicated on a few critical items: (1) the federal budget will have to come into some kind of balance, (2) the US will have to become much more competitive in world markets, (3) inflation will have to remain low, yet not turn into real deflation, and (4) interest rates will have to come down and stay down.

It is well to note that each of the three consolidations shown on the chart were accompanied by inflation. Furthermore, it is



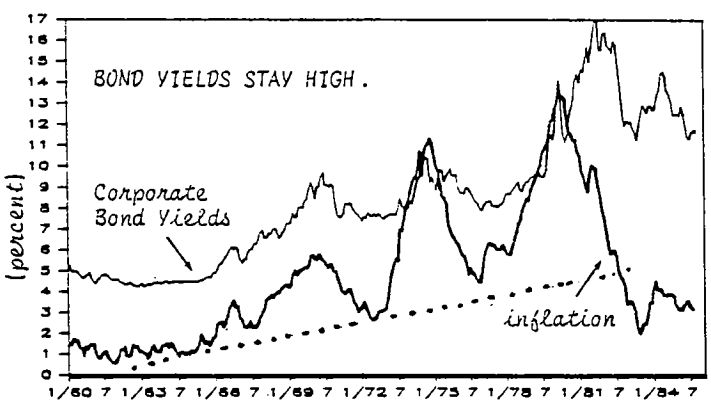
fascinating to note that inflation subsided as each of the upside breakouts occurred. Is the market telling us that we are now entering an extended period of non-inflation? If the chart has any validity, this is exactly what the market is telling us as the Dow fluctuates far above the breakout point of 1051.

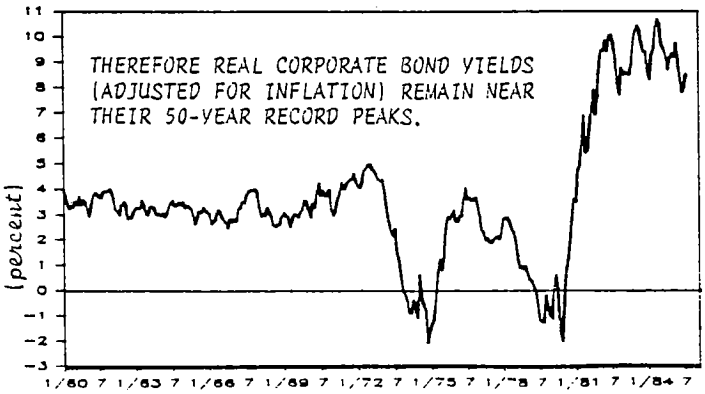
In closing this piece I want to reprint the exact words that I wrote when I published this chart on May 18, 1983: "But I am trying to get over two basic points at this time. (1) The breakout from the 17-year consolidation period indicates that this is a different kind of primary bull market than anything most Wall Streeters have seen (unless you were in the market during the early 1960s). (2) An ultimate doubling or even tripling of the Dow is possible during the period ahead. There is precedent for that statement, based on the performance of the Dow (upon breaking out of long consolidation ranges) in the past.

"On top of that all the major averages and indices have confirmed the Dow by rising into record high ground.The PTI, which told the story all along, is pushing to record highs. And I feel that if one has any belief in the wisdom of markets, one has to believe that this market is telling us a bullish story."

**BONDS, RATES:** With the inflation rate holding low month after month, why has it taken so long for the long-term interest rates to come down (normally, the long-term rates are roughly 3% above the prevailing inflation rates)? One reason is that investors are almost always guided by the recent past, and in the case of bonds investors have been influenced by decades of depressing inflationary history. What does history tell investors? It tells them that over any extended period of time America's politicians (along with the Fed) will opt for inflation. Thus, any lull in the inflation rate is always taken to be just that -- a lull -- preparatory to the next round of inflation.

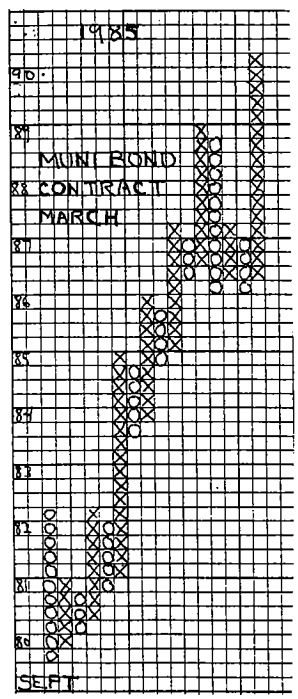
Is that the story? Is that what we are seeing now with today's 3-4% rate of inflation? Personally, I'm not at all convinced. I have shown in charts where the inflation rate of the last 30 years has been broken. In fact, this chart (courtesy of my old friends at Weiss Research, Box 2923, W. Palm Beach, FL 33402) shows exactly what I'm talking about. Here we see the inflation rate going back to the early 1960s being violated -- while the bond yields still stay in the high area. It's clear that bond buyers still distrust the break in inflation. It's clear that they still expect inflation to heat up again (if they didn't, long-term bond yields would be down in the 6-7% range today). Further evidence of very high bond yields is seen in the second chart which depicts "real" corporate bond yields, which are still very fat and very attractive.





THEREFORE REAL CORPORATE BOND YIELDS (ADJUSTED FOR INFLATION) REMAIN NEAR THEIR 50-YEAR RECORD PEAKS.
(percent)
1/60 7 1/63 7 1/66 7 1/69 7 1/72 7 1/75 7 1/78 7 1/81 7 1/84 7

But there's a catch in the old inflation argument, and I've been talking about it ever since 1980. I felt in 1980 (when gold topped out) that the forces of deflation had finally overcome the forces of inflation. I felt that the enormous US debt, and the methods needed to control that debt, would be deflationary. I still believe that, and today's Gramm-Rudman bill is just one step in the shrinking (deflationary) process. Of course, the bond market has not been oblivious to all this. As I've shown in chart after chart, the bonds are finally marching to the lower-inflation tune. If you will glance at the list of Treasury bonds published in almost every newspaper you will see that the long-term bond yields have now dropped below 10%. Thus, we have single-digit long-term yields on Treasury bonds for the first time in five years. And all of us who bought bonds over the past four years have medium to fat profits.

In case you want an updated picture of how your bonds are doing, here's my chart of the March muni bond futures. The chart is strongly bullish with a recent important upside breakout above 84. The best action here would be a consolidation, and then an additional upside breakout.




**NOTES & QUOTES:**
Deficits, Taxes, Problems: Nobody wants to shout it out loud, but it looks more and more as if 1986 is going to see a tax increase. The Office of Budget and Management now says that for all the efforts to trim the budget, the deficit for fiscal 1986 looks like "over $200 billion" again. Gramm-Rudman has now passed. But nobody yet knows where the big cuts will come from. Reagan doesn't want military cuts, he doesn't want Social Security cuts and Congress doesn't want too many social program cuts. No one in Washington believes that Congress will go along with the severe cuts that will be needed to satisfy Gramm Rudman, so what happens next?

The Russell prediction: Reagan will see the light (i.e., he'll compromise and taxes will go up next year. A possibility, VAT or a national sales tax. My own suggestion: (1) drop the whole "tax reform" nonsense

(it's not tax reform, it's tax switching) and (2) cut spending across the board including the military, and (3) institute a national sales tax that will raise at least $50 billion. Then mandate that all receipts from the sales tax go towards reducing the deficit. But count on it -- taxes WILL go up in 1986.

* *

If there's a 1980s answer to Mark Twain and Will Rogers, it's Russell Baker of the New York Times, Last week Baker wrote a piece on White House Staff Fuhrer Don Regan. I include a condensed version of that gem here:

You have to like the way Donald Regan has taken charge as White House chief of staff.

He is a take-charge guy.

He has put everybody on notice that a take-charge guy has now taken charge. He has sent them a message:

"Shape up or ship out."

Remember Margaret Heckler? Of course not. She was a member of the President's Cabinet. Secretary of Health and Human Services. Being in the President's Cabinet these days is not like having a role in a TV sitcom. You don't get heard of, much less remembered, especially if you are Secretary of Health and Human Services. This is why you don't remember Margaret Heckler.

But somebody remembered Margaret Heckler. That somebody was Donald Regan. "What have you been doing today?" the President asked him late one evening.

"Remembering Margaret Heckler," said Donald Regan.

"Is Margaret Heckler somebody I ought to know?" the President asked.

Donald Regan took charge. "Don't bother your head about it," he said. "I'll handle this."

Margaret Heckler hadn't shaped up, so Donald Regan shipped her out. Soon she will be our Ambassador in Dublin.

While worrying about the lack of shape-up along the phone lines, Donald Regan realized that a man at the President's very elbow was bothering the President's head with parochial concerns about diplomacy and warfare.

This man was Robert McFarlane, the President's national security adviser.

Robert McFarlane had not shaped up.

A man who had shaped up would not bother the President's head before talking it over with Don Regan, saying, "Do you think we ought to bother the President's head about this one?"

Robert McFarlane had not shaped up so he shipped out.

When the President asked why, he was told Robert McFarlane wanted to hunt for a job that paid better than the White House.

"Isn't it strange," asked the President, "that an old marine like Robert McFarlane who has devoted his whole life to the national security field would quit when he's got the best job available in his line of work, and just so he can make a little more money selling insurance, or advice, or whatever he's going to sell?"

"Don't bother your head about that," said Donald Regan.

But the President's question troubled Donald Regan. It had a subtlety that was inconsistent with the President's blunt, open, regular-guy style. Somebody had planted that question in the President's head. Somebody very, very close to the President. That somebody was bothering the President's head. That somebody had not shaped up.

Who could it be if not Nancy Reagan?

Donald Regan is studying lists of places to which a First Lady can be plausibly shipped out without raising too many eyebrows. After which the problem of her husband can be tackled. Unless of course, having seen the First Lady shipped out, the President takes the hint and starts to shape up. □

* *

Musings on Age: My father once sat me down (I guess I was about 22), and he said, "Dick, you know when I was a young man I was bent on beating the world. But when I got older, I got a little smarter, and I realized that nobody beats the world. In fact, if you insist on beating the world you'll probably find that the world will beat you. So just be a decent person, and do your best. That's all you can offer the world -- your best."

As I get older, I often think back on my father's words. And I understand what he was trying to say. I was thinking today that if my father were still living he would be 93. But he died at age 64, and unfortunately he had only seen one of my children. I wish more than anything that he could have seen them all (all five of them).

I appreciate people who live to very old age. They've seen so much, they've fought so many battles. Many have lived through one or two wars, some have outlived one or two spouses. Most have had their triumphs and disasters. And the tragic fact is that almost all those stories, all those individual histories, die with the individuals.

What did your great-great grandfather do? What were his dreams? Where did he live? Who were his loves? Do any of us know? Yet we descended from those distant, generally forgotten, parents. And their stories (at least 99.9% of them ) are gone, buried with them. I only knew one of my grandparents. That was my grandfather on my mother's side. He had a furniture store in NYC during the 1920s. The Great Depression killed his business, and it killed him. Later his house in Far Rockaway, N.Y., was sold (around 1935) for $2,000! Think of the tragedy of his last years. Think of his pain, his agony. Yet, he never told me his story. I was too young to hear it.

Somewhere the story of billions of people is written. Certain religious groups believe that everybody's stories are written in minute detail in heavenly Akashic records. I don't know, but if it's true, what I wouldn't give to look through those records. They would tell where we came from and why. Those stories would provide fabulous plots for Hollywood for the rest of time.

* *

You want to write a successful book? Then you better do one of two things: (1)Be able to write awfully well, or (2) get a good review from the New York Times book section. The NY Times' section towers over ALL other book review sources. It is THE power. The NY Times book section appears on Sunday with a Sunday circulation of 1.6 million plus 77,000 separately sold book sections. Book publishers say that 70 to 80% of all their newspaper ads go to the NY Times. The Times' section averages 41 pages compared to 12 for the LA Times, 16 for the Wash. Post. Very few newspapers have professional reviewers on their book sections: The LA Times has two, the Wash. Post has four, the NY Times has 21! Few institutions, in brief, have the power of the NY Times book section. It is in a class by itself -- and I love that section!

* *

Where's the action in commodities? It's not in the classic commodities at all, it's in the newer financial futures. Here are the number of contracts traded in the top commodities of 1980: Corn

Corn 11.9 million contracts, soybeans 10.7 million contracts, gold 8.0 million, T-bonds 6.4 million. Now let's look at 1985 just through Oct. 31: T-bonds 32.3 million, S&P 500 12.3 million, 3-month Eurodollars 7.4 million, gold 6.7 million, soybeans 5.9 million.

So I guess you can say, "Corn, beans and wheat feed the world -- but money and financials run the world."

* *

Wall Street and its satellites have always been eager to provide whatever the public will buy. I remember back in 1958 it was said that there was "a shortage of good stocks". Boy, did Wall Street provide more! By 1961 the market was flooded with splits and new issues. Then during the '70s the public started taking to mutual funds. Count the number of funds now listed in your local newspaper. It's moving

toward infinity. But how do you monitor the funds? Easy, with advisory services which monitor the funds. I just counted 17 publications which monitor mutual funds, and I probably missed some. When there's a need, Wall Street will fill it -- or should I say flood it?

* *

In a vote by university presidents for the best national universities in the nation, Stanford came in first, Harvard second, Yale third, Princeton fourth (this from a choice of 192 universities). Most expensive of the top 10 picks -- Harvard at $11,340 (tuition). Number 1 Stanford received 17 applicants for every one picked. One of every 6 Stanford applicants had a straight-A average. Another interesting statistic -- Stanford's endowment: over $1 billion.

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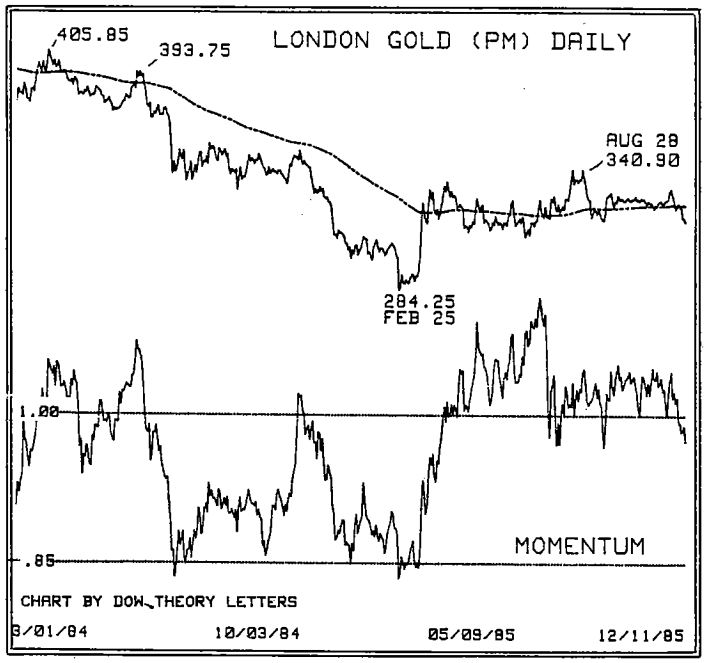
FYI Dept: Did you know that if you post bail and then run off to hide in some other state a bail bondsman can do the following: He can break the lock on your door, kick your door down, throw you in handcuffs, slap you in the back of his car and drive you back to the court. And all this without a legal warrant! This is a paragraph from a fascinating article in the January Los Angeles magazine.

> Actually, bail bondsmen exist in a legal lacuna: They're not technically officers of the court or police, but they enjoy extensive legal power under the state penal code. As guarantors of the court, they hold the status of an arm of the prosecution process; they have the same arrest rights as sworn law officers—and considerably more. In apprehending an escapee, they may break down any door or smash any locks without the legal warrants required of police officers and sheriffs. Further, it's their prerogative to pursue skips into all 50 states and bring them home without having to follow traditional processes of interstate extradition.

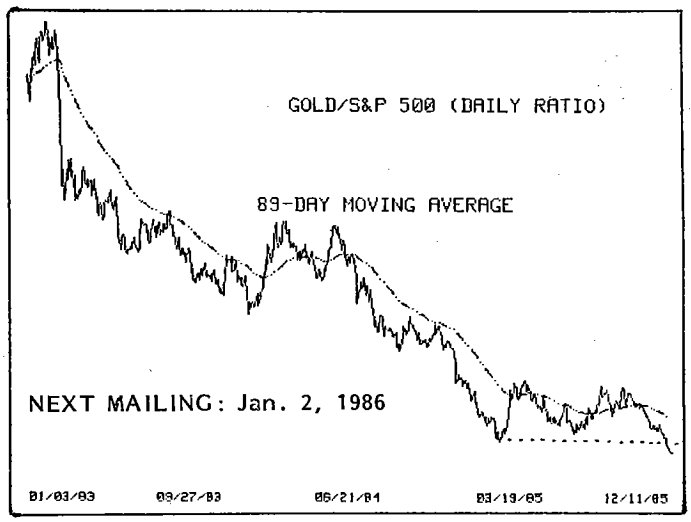
**GOLD:** With few exceptions, each year sees gold making a low sometime in the fourth quarter. The metal then tends to rally into the first quarter. Last week (Dec. 11) we saw a low London fix of 315.50. The swoon in gold came as crude oil got hit hard, and the thought, "deflation", was on every trader's mind. Actually, the gold and precious metal action is hardly encouraging here, but all is not lost, at least not yet. As you can see on my chart, gold has broken below its 144-day moving average and gold momentum (89-day rate-of-change) has sunk below the zero line . Thus, the chart now shows gold in the bearish mode for the first time in many weeks.

But goldphiles have two things in their favor: (1) there is that usual fourth quarter low, and we might have seen it. (2) Gold is still holding above its 284.25 low of last February. Thus, as I say, all is not lost, but on the other hand the gold picture is hardly one to warm the hearts of the hard money crowd.

Me, I continue to buy a few coins each month, and since I am buying a fixed number of coins -- if the price of gold falls, I simply pay less. Now to tell the truth I wouldn't average down in units of anything else. But gold has one unique property: it never goes out of style, it never goes bankrupt, it never dissolves, it never burns, tarnishes, tears or decomposes. Therefore, it does not worry me to average down in gold coins. Besides, as I said in the last Letter, those Maple Leafs and Pandas and Kronas are beautiful to look at. I'll never sell them. My kids will get them some day.




And now, something for the goldphobes (they hate the stuff). This is a chart I often show. One of the things I have learned is that the background for gold is negative as long as the ratio of gold divided by a major stock average is trending down. Well here is gold divided by the S&P 500. And the direction is down, following last week's renewed plunge. So if you're thinking of taking a real (major) position in gold, my advice is -- forget it. It is still waiting time for real gold buyers. Gold's time has not yet arrived.




**LATE NOTES:** You can spend a quarter of a century on Wall Street and not see action comparable to the week ending December 13. On record weekly volume of over 800 million shares almost every average, index and indicator hit record highs. It was a case of panic, and the panic started months ago with bond buyers rushing in to lock in declining yields -- and with stock buyers following their lead. But last week saw further panic as professionals and fund managers poured in to swap burgeoning cash hoards for stocks and bonds. Additional panic buying came from a record number of trapped and petrified short sellers. Finally, there was a panic on the part of the public, a public which was left confused and frustrated as they watched one of the great advances of Wall Street history in full progress -- but progressing without them.